

## Internal Revenue Service, Treasury

## §3.1

1971, or the date of the deposit in the old fund, whichever is the later.

### (k) Definitions.

For purposes of this section—

(1) The term “eligible vessel” means any vessel—

(A) Constructed in the United States and, if reconstructed, reconstructed in the United States,

(B) Documented under the laws of the United States, and

(C) Operated in the foreign or domestic commerce of the United States or in the fisheries of the United States.

Any vessel which (i) was constructed outside of the United States but documented under the laws of the United States on April 15, 1970, or (ii) constructed outside the United States for use in the United States foreign trade pursuant to a contract entered into before April 15, 1970, shall be treated as satisfying the requirements of subparagraph (A) of this paragraph and the requirements of subparagraph (A) of paragraph (2).

(2) The term “qualified vessel” means any vessel—

(A) Constructed in the United States and, if reconstructed, reconstructed in the United States,

(B) Documented under the laws of the United States, and

(C) Which the person maintaining the fund agrees with the Secretary of Commerce will be operated in the United States foreign, Great Lakes, or noncontiguous domestic trade or in the fisheries of the United States.

(3) The term “agreement vessel” means any eligible vessel or qualified vessel which is subject to an agreement entered into under this section.

(4) The term “United States,” when used in a geographical sense, means the continental United States including Alaska, Hawaii, and Puerto Rico.

(5) The term “United States foreign trade” includes (but is not limited to) those areas in domestic trade in which a vessel built with construction-differential subsidy is permitted to operate under the first sentence of section 506 of this Act.

(6) The term “joint regulations” means regulations prescribed under subsection (1).

(7) The term “vessel” includes cargo handling equipment which the Secretary of Commerce determines is intended for use primarily on the vessel. The term “vessel” also includes an ocean-going towing vessel or an ocean-going barge or comparable towing vessel or barge operated on the Great Lakes.

(8) The term “noncontiguous trade” means (i) trade between the contiguous forty-eight States on the one hand and Alaska, Hawaii, Puerto Rico, and the insular territories and possessions of the United States on the other hand, and (ii) trade from any point in Alaska, Hawaii, Puerto Rico, and such territories and possessions to any other point in Alaska,

Hawaii, Puerto Rico, and such territories and possessions.

(l) Records; Reports; Changes in Regulations.

Each person maintaining a fund under this section shall keep such records and shall make such reports as the Secretary of Commerce or the Secretary of the Treasury shall require. The Secretary of the Treasury and the Secretary of Commerce shall jointly prescribe all rules and regulations, not inconsistent with the foregoing provisions of this section, as may be necessary or appropriate to the determination of tax liability under this section. If, after an agreement has been entered into under this section, a change is made either in the joint regulations or in the regulations prescribed by the Secretary of Commerce under this section which could have a substantial effect on the rights or obligations of any person maintaining a fund under this section, such person may terminate such agreement.

### §3.1 Scope of section 607 of the Act and the regulations in this part.

(a) *In general.* The regulations prescribed in this part provide rules for determining the income tax liability of any person a party to an agreement with the Secretary of Commerce establishing a capital construction fund (for purposes of this part referred to as the “fund”) authorized by section 607 of the Merchant Marine Act, 1936, as amended (for purposes of this part referred to as the “Act”). With respect to such parties, section 607 of the Act in general provides for the nontaxability of certain deposits of money or other property into the fund out of earnings or gains realized from the operation of vessels covered in an agreement, gains realized from the sale or other disposition of agreement vessels or proceeds from insurance for indemnification for loss of agreement vessels, earnings from the investment or reinvestment of amounts held in a fund, and gains with respect to amounts or deposits in the fund. Transitional rules are also provided for the treatment of “old funds” existing on or before the effective date of the Merchant Marine Act of 1970 (see §3.10).

(b) *Cross references.* For rules relating to eligibility for a fund, deposits, and withdrawals and other aspects, see the regulations prescribed by the Secretary of Commerce in titles 46 (Merchant Marine) and 50 (Fisheries) of the *Code of Federal Regulations*.

(c) *Code*. For purposes of this part, the term “Code” means the Internal Revenue Code of 1954, as amended.

### § 3.2 Ceiling on deposits.

(a) *In general*—(1) *Total ceiling*. Section 607(b) of the Act provides a ceiling on the amount which may be deposited by a party for a taxable year pursuant to an agreement. The amount which a party may deposit into a fund may not exceed the sum of the following subceilings:

(i) The lower of (a) the taxable income (if any) of the party for such year (computed as provided in Chapter I of the Code but without regard to the carryback of any net operating loss or net capital loss and without regard to section 607 of the Act) or (b) taxable income (if any) of such party for such year attributable under paragraph (b) of this section to the operation of agreement vessels (as defined in paragraph (f) of this section) in the foreign or domestic commerce of the United States or in the fisheries of the United States (see section 607(b)(1)(A) of the Act).

(ii) Amounts allowable as a deduction under section 167 of the Code for such year with respect to the agreement vessels (see section 607(b)(1)(B) of the Act),

(iii) The net proceeds (if not included in subdivision (i) of this paragraph) from (a) the sale or other disposition of any agreement vessels or (b) insurance or indemnity attributable to any agreement vessels (see section 607(b)(1)(C) of the Act and paragraph (c) of this section), and

(iv) Earnings and gains from the investment or reinvestment of amounts held in such fund (see section 607(b)(1)(D) of the Act and paragraphs (d) and (g) of this section).

(2) *Overdeposits*. (i) If for any taxable year an amount is deposited into the fund under a subceiling computed under subparagraph (1) of this paragraph which is in excess of the amount of such subceiling for such year, then at the party's option such excess (or any portion thereof) may—

(a) Be treated as a deposit into the fund for that taxable year under another available subceiling, or

(b) Be treated as not having been deposited for the taxable year and thus, at the party's option, may be disposed of either by it being—

(1) Treated as a deposit into the fund under any subceiling available in the first subsequent taxable year in which a subceiling is available, in which case such amount shall be deemed to have been deposited on the first day of such subsequent taxable year, or

(2) Repaid to the party from the fund.

(ii)(a) When a correction is made for an overdeposit, proper adjustment shall be made with respect to all items for all taxable years affected by the overdeposit, such as, for example, amounts in each account described in § 3.4, treatment of nonqualified withdrawals, the consequences of qualified withdrawals and the treatment of losses realized or treated as realized by the fund. Thus, for example, if the party chooses to have the fund repay to him the amount of an overdeposit, amounts in each account, basis of assets, and any affected item will be determined as though no deposit and repayment had been made. Accordingly, in such a case, if there are insufficient amounts in an account to cover a repayment of an overdeposit (as determined before correcting the overdeposit), and the party had applied the proceeds of a qualified withdrawal from such account towards the purchase of a qualified vessel (within the meaning of § 3.11(a)(2)), then such account and the basis of the vessel shall be adjusted as of the time such withdrawal was made and proceeds were applied, and repayment shall be made from such account as adjusted. If a party chooses to treat the amount of an overdeposit as a deposit under a subceiling for a subsequent year, similar adjustments to affected items shall be made. If the amount of a withdrawal would have exceeded the amount in the fund (determined after adjusting all affected amounts by reason of correcting the overdeposit), the withdrawal to the extent of such excess shall be treated as a repayment made at the time the withdrawal was made.

(b) If the accounts (as defined in § 3.4) that were increased by reason of excessive deposits contain sufficient amounts at the time the overdeposit is